

Audit Report



DISTRIBUTION DEPOT REVENUES

Report Number 98-075

February 13, 1998

Office of the Inspector General
Department of Defense

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Acronyms

CCP	Container Consolidation Point
DBOF	Defense Business Operations Fund
DLA	Defense Logistics Agency
DWCF	Defense Working Capital Fund

February 13, 1998

MEMORANDUM FOR DIRECTOR, DEFENSE LOGISTICS AGENCY

SUBJECT: Audit Report on Distribution Depot Revenues (Report No. 98-075)

We are providing this report for information and use. This is the seventh and final report in a series of reports related to FY 1996 revenues in the Defense Business Operations Fund.

We considered management comments on a draft of the report in preparing this report. The Defense Logistics Agency comments conformed to the requirements of DoD Directive 7650.3; therefore, additional comments are not required.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. Richard B. Bird, Audit Program Director, at (703) 604-9175 (DSN 664-9 175), e-mail RBird@DODIG.USD.MIL, or Mr. Byron B. Harbert, Audit Project Manager, at (303) 676-7405 (DSN 926-7405), e-mail BHarbert@Cleveland.DFAS.MIL. See Appendix C for the report distribution. The audit team members are listed inside the back cover.



David K. Steensma
Deputy Assistant Inspector General
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Office of the Inspector General, DoD

Report No. 98-075

(Project No. SFD-2020.07)

February 13, 1998

Distribution Depot Revenues

Executive Summary

Introduction. The issue of Distribution Depot revenues was identified during our audit of the revenue accounts in the FY 1996 Defense Business Operations Fund financial statements (the revenue accounts audit). The revenue accounts audit was initiated to support the Chief Financial Officers Act of 1990 (Public Law 101-576, November 15, 1990) as amended by the Federal Financial Management Act of 1994 (Public Law 103-356, October 13, 1994). In FY 1996, DoD reported \$73.7 billion of revenues in the Defense Business Operations Fund, \$1.2 billion of which were attributable to the Defense Logistics Agency Distribution Depot business area. This is the seventh and final report in a series of reports on issues related to FY 1996 revenues in the Defense Business Operations Fund. See Appendix B for details of those reports.

In December 1996, the Under Secretary of Defense (Comptroller) announced that the Defense Business Operations Fund would be realigned into five working capital funds; one of these funds is the Defense-Wide Working Capital Fund, which includes the Distribution Depot business area. That realignment does not affect the issues discussed in this report.

Audit Objectives. The overall revenue accounts audit objective was to determine whether revenues on the FY 1996 Defense Business Operations Fund consolidated financial statements were presented fairly in accordance with the "other comprehensive basis of accounting" described in Office of Management and Budget Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993. For this portion of the audit, we examined revenues recognized by the Distribution Depot business area. In addition, we assessed management controls as applicable to the overall audit objective.

Audit Results. The Distribution Depot business area was not reimbursed for all transportation and container consolidation point services. Customers were only billed \$126 million of the \$275.5 million of costs incurred. As a result, the Distribution Depot business area lost approximately \$150 million in FY 1996, and the lack of full reimbursement was not disclosed in the FY 1996 financial statements (Finding A).

The Distribution Depot business area continued to provide services to customers in advance of, or in excess of the amount of, funded orders. Cumulative unfunded services ranged from \$1 million to \$75.4 million per month during the 15-month period ended December 31, 1996. As a result, the Distribution Depot business area experienced cumulative cash disbursements that exceeded cumulative cash collections by as much as \$18.4 million during FY 1996. Cash shortages had to be covered by other Defense Business Operations Fund sources (Finding B).

See Appendix A for details on the material management control weaknesses on the disclosure of funding deficiencies in the financial statements and the reimbursement for services.

Summary of Recommendations. Management has implemented plans to require that customers budget increased amounts for the costs of transportation and container consolidation point services beginning in FY 1998 and for the Distribution Depot business area to bill full costs to customers beginning in FY 1999. Therefore, we are making no recommendations to correct the condition that resulted in a loss of approximately \$150 million. However, we recommend that the Director, Defense Logistics Agency, disclose the nature and amounts of any future losses resulting from not billing customers for full costs in the Distribution Depot business area financial statements.

Management has initiated corrective action to minimize the necessity for the Distribution Depot business area to provide services to customers in advance of, or in excess of, funded orders. A recommendation proposed by the Defense Working Capital Fund Study Group and approved by the Under Secretary of Defense (Comptroller) should give customers an incentive to provide timely funded orders and enable distribution depots to collect amounts past due within a reasonable period of time. Accordingly, we are not making a recommendation at this time regarding the lack of timely funded orders provided to Distribution Depots.

Management Comments. The Defense Logistics Agency concurred with the recommendation, agreeing to fully disclose the nature and amount of the losses in financial statements. See Part I for a complete discussion of management comments and Part III for the complete text of management comments.

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Part I - Audit Results

Audit Background

The issue of distribution depot revenues was identified during our audit of "Revenue Accounts in the FY 1996 Financial Statements of the Defense Business Operations Fund (DBOF)" (the revenue accounts audit). The revenue accounts audit was performed to meet requirements of the Chief Financial Officers Act of 1990 (Public Law 101-76, November 15, 1990) as amended by the Federal Financial Management Act of 1994 (Public Law 103-356, October 13, 1994). The Chief Financial Officers Act requires DoD to prepare annual, audited financial statements for the preceding year and submit them to the Director, Office of Management and Budget. These financial statements report the financial position and results of operations of the DBOF organizations.

For FY 1996, DoD reported \$73.7 billion of revenues in the DBOF, \$1.2 billion of which were attributable to the Distribution Depot business area. This is the seventh and final report in a series of reports on issues related to FY 1996 DBOF revenues. See Appendix B for details of those reports.

In December 1996, the Under Secretary of Defense (Comptroller) announced that the DBOF would be realigned into five working capital funds; one of these funds is the Defense-Wide Working Capital Fund, which includes the Distribution Depot business area. That realignment does not affect the issues discussed in this report.

Audit Objectives

The overall revenue accounts audit objective was to determine whether revenues on the FY 1996 DBOF consolidated financial statements were presented fairly in accordance with the "other comprehensive basis of accounting" described in Office of Management and Budget Bulletin 94-01, "Form and Content of Agency Financial Statements," November 16, 1993. For this portion of the audit, we reviewed FY 1996 revenue for the Distribution Depot business area. In addition, we assessed management controls and compliance with laws and regulations as applicable to the overall audit objective. See Appendix A for a discussion of the audit scope and methodology and for a review of the management control program. See Appendix B for a discussion of prior audit coverage.

Finding A. Reimbursement for Services

The Defense Logistics Agency (DLA) Distribution Depot business area was not reimbursed for all transportation and container consolidation point (CCP) services in FY 1996. This lack of full reimbursement was not disclosed in the FY 1996 financial statements. Customers were billed only \$126 million of \$275.5 million of costs incurred because DoD policy prevented DBOF entities from billing customers in excess of funded amounts. DLA Distribution Depot business area customers budgeted for and funded \$126 million for transportation services but did not budget for or fund CCP services. In addition, DLA officials had not developed a methodology to allocate the cost of services provided to specific customers and had not developed stabilized rates or unit prices for CCP services. DLA officials overlooked the need to disclose in the financial statements the lack of full reimbursement to DBOF. As a result, the Distribution Depot business area lost approximately \$150 million in FY 1996, and the financial statements did not include information important to users of those financial statements.

Revenue Recognition and Reimbursement Policy

DoD 7000.14-R, "DoD Financial Management Regulation," volume 1 1B, "Reimbursable Operations, Policy and Procedures-Defense Business Operations Fund," December 21, 1994, governs revenue recognition and reimbursement for all DBOF organizations:

Reimbursement Principles. As a general principle, each activity operating under the Defense Business Operations Fund shall be reimbursed for the costs of all goods and services ordered and produced as a result of those orders. The nature of the Defense Business Operations Fund requires ordering agencies to budget, control, and account for the cost of all goods and services ordered. As a result, a Defense Business Operations Fund activity shall bill ordering activities for all costs incurred as a result of an accepted order.

Revenue Billings. In no case shall the total amount of revenue recognized and billed exceed the amount of the order.

Finding A. Reimbursement for Services

Revenue Recognition Policy. The amount of revenue recognized cannot exceed the amount specified in the order. Activities in the Distribution Depot business area shall recognize revenue, and related costs, based on issue and receipt of materiel or the rendering of service.

Reimbursement Basis. Billings to the Department of Defense and other Federal Government customers shall be developed on the basis of either stabilized unit prices, or stabilized rates. Stabilized rates and unit prices shall be established to recover operating expenses estimated to be incurred for the applicable fiscal year. (That is, stabilized rates and unit prices shall be established at levels intended to provide for estimated revenues to equal estimated costs plus approved surcharges for the applicable fiscal year for which the rates and unit prices are established.)

Stabilized rates are prices established for an entire fiscal year and protect appropriated fund customers from unforeseen cost changes. Stabilized rates may not be changed without the approval of the Under Secretary of Defense (Comptroller).

Transportation Services Policy

DoD 5000.32-R, "Military Standard Transportation and Movement Procedures," volumes I and II, March 15, 1987, and February 15, 1987, issue DoD policy for the transportation and movement of materiel. DoD transportation operating agencies provide or arrange for transportation services and bill customers for transportation costs. As the shipping organization, the Distribution Depot business area is the customer of the DoD transportation operating agencies. As the customer, the Distribution Depot business area pays the cost of over-ocean second-destination transportation, which is the transportation of materiel from a DLA depot in the continental United States to an overseas materiel requisitioner. These costs are then reimbursed to the Distribution Depot business area by the Military Department and DLA materiel managers that directed the depots to ship the materiel to the requisitioner.

CCP Services Policy

On December 23, 1993, the Deputy Under Secretary of Defense (Logistics) issued a memorandum, subject: "Definitions of Distribution Depot Functions." The memorandum stated that the purpose of a CCP is to combine shipments from multiple shippers to generate full container or air pallet loads of cargo for direct shipment to overseas customers. The memorandum also stated that CCP processing operations shall be reimbursed by a reimbursable order from the customer. The DLA identified the reimbursable customer of this service as the Military Department and DLA materiel managers who directed the depots to ship the materiel.

Revenue and Costs

The Distribution Depot business area recognized total revenue of \$126 million and net costs of \$275.5 million for over-ocean second-destination transportation and CCP services.

Transportation Services. In FY 1996, the Distribution Depot business area recognized \$126 million of revenue from over-ocean second-destination transportation services. This revenue was recognized at one-twelfth of \$126 million each month and reimbursement was not based on stabilized rates, but was equal to the amount customers had budgeted and funded for these services. Associated costs were \$282.6 million. These costs included an estimated \$42 million of costs that should have been billed to other DoD organizations but were erroneously charged to the Distribution Depot business area. We reported the erroneous charges in IG, DoD, Report No. 97-040, "Distribution Depot Over-Ocean Second-Destination Transportation Costs," December 10, 1996. The net amount of associated cost identified to the over-ocean second-destination transportation services is \$240.6 million. DLA agreed with the recommendation to establish procedures that require payments be made only for transportation costs that apply to the Distribution Depot business area.

CCP Services. In FY 1996, the Distribution Depot business area recognized no revenue from CCP services because customers had not budgeted for or funded those services. In addition, DLA had not developed a methodology for billing at stabilized rates. Associated costs were \$34.9 million.

Finding A. Reimbursement for Services

DoD Comptroller Guidance

On July 11, 1996, the Principal Deputy Under Secretary of Defense (Comptroller) issued a memorandum regarding the FY 1998/1999 Defense Biennial Budget Review. This memorandum contained policy on budgeting for distribution depot costs for transportation and CCP services:

Over Ocean Transportation/Container Consolidation and Packaging. Over Ocean Transportation and CCP costs are currently paid by the Distribution Depot business area and then incompletely charged to materiel manager customers who established the requirement for the transportation/packaging. As discussed in PBD (Program Budget Decision) 402 of December 7, 1995, only a portion of these costs are presently included in distribution depot rates. As directed in PBD 402, the currently unfunded portions of these charges must be budgeted in the FY 1998/1999 rates.

Allocation of Costs

N 1996 through N 1998. For FY 1996, DLA had not developed a methodology to allocate the costs of transportation and CCP services provided to the specific materiel manager that had directed the movement of the materiel. During FY 1996, five methodologies were developed to allocate those costs. However, DLA does not plan to implement any of these methodologies before FY 1999. DLA plans to continue recognizing revenue for transportation services and CCP processing services based on amounts budgeted and funded through FY 1998.

N 1999. To resolve questions regarding the allocation of costs for over-ocean second-destination transportation and CCP services, the DLA Comptroller issued a memorandum, subject: "Funding of CONUS and OCONUS Second Destination Transportation (SDT)," October 8, 1996. The memorandum proposes that the Director, Revolving Funds, Office of the Deputy Comptroller (Program/Budget), and the Assistant Deputy Under Secretary of Defense (Transportation Policy) sponsor a process action team to explore alternative methods of allocating transportation costs. The team was tasked to develop alternatives for allocating transportation costs and make recommendations to the DBOF Corporate Board, so that a final decision could be incorporated in the FY 1999 budget guidance. DLA personnel stated that an alternative for allocating CCP costs would also be explored by the process action team.

Financial Statement Disclosure

Note 1 .A. to the FY 1996 financial statements for the Distribution Depot business area erroneously states that the accounting standards followed in preparing the statements were as prescribed by the Federal Accounting Standards Advisory Board; DoD 7220.9-M, "DoD Accounting Manual," as amended January 31, 1994; and DoD 7000.14-R. This note, and other disclosures in the financial statements, failed to disclose that the Distribution Depot business area did not use stabilized rates or prices to obtain full reimbursement from customers for over-ocean second-destination transportation and CCP services, as required by DoD 7000.14-R. DLA personnel stated that they overlooked the need to disclose the lack of full reimbursement.

Summary

The Distribution Depot business area lost approximately \$150 million in FY 1996 for transportation and CCP services. The \$150 million loss was included in the amount of the results of operations for the Distribution Depot business area in the FY 1996 financial statements. However, because the Principal Deputy Under Secretary of Defense (Comptroller) has implemented plans requiring that customers budget for those costs beginning in FY 1998 and because the DLA has implemented plans for the Distribution Depot business area to bill full costs to customers beginning in FY 1999, we are making no recommendations to correct the condition. However, in the interim, DLA should disclose the amounts of any losses resulting from not billing customers for full costs in a footnote to the DLA working capital fund financial statements.

Finding A. Reimbursement for Services

Recommendation for Corrective Action

A. We recommend that the Director, Defense Logistics Agency, disclose the nature and amounts of future losses resulting from not charging customers for full costs of transportation and container consolidation point services in the Distribution Depot business area financial statements.

Management Comments

The Defense Logistics Agency concurred with the recommendation and will disclose the nature and amount of these losses in the FYs **1997 and 1998 financial statements.**

Finding B. Funding Depot Services

The Distribution Depot business area continued to provide services to working capital fund customers in advance of or in excess of the amount of funded orders. Cumulative unfunded services ranged from \$1 million to \$75.4 million per month during the 15-month period ended 31 December 1996. This condition was caused by the need to provide services to meet mission requirements and by the lack of consequences for customers not providing funds when due. As a result, the Distribution Depot business area experienced cumulative cash disbursements that exceeded cumulative cash collections by as much as \$18.14 million during FY 1996. Cash shortages had to be covered by other DBOF sources.

Financial Policy

DoD 7000.14-R, "DoD Financial Management Regulation," volume 1 1B, "Reimbursable Operations, Policy and Procedures-Defense Business Operations Fund," December 21, 1994, states that as a general rule, no work or services should be performed by a DBOF organization except on the basis of reimbursable orders received and accepted that constitute obligations of Federal ordering organizations. Work may begin in advance of receipt and acceptance of a formal order under two circumstances:

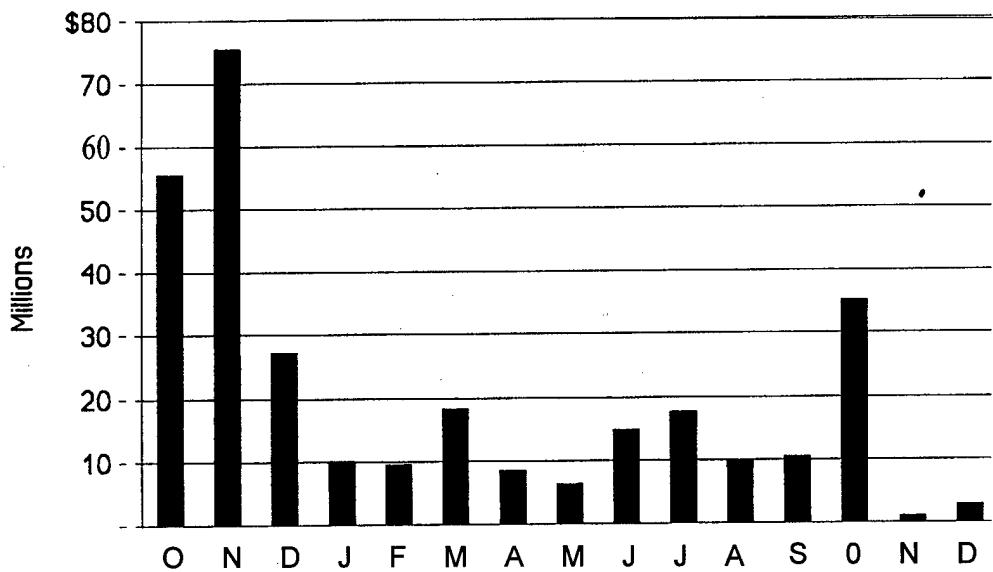
Letter of Intent Orders. When it is desirable, in the interest of economical operations, to incur limited costs in advance of the receipt of a regular order for an authorized program for which customer funds are available, such work or services may be undertaken on the basis of a letter of intent. This letter constitutes an obligation of the ordering activity in a stated amount sufficient to cover the advance costs that may be incurred.

Commanding Officer's Orders. When it is necessary to begin work of an emergency nature prior to the receipt of an order, a commanding officer's order or similar order may be issued by the commander of the Defense Business Operations Fund activity.

Finding B. Funding Depot Services

Funding Services

The Distribution Depot business area provides issue, receipt, storage, and over-ocean second-destination transportation services for inventory items that are owned and managed by materiel managers of the Army, Navy, Air Force, and DLA. Supply system customers pay for these services via a surcharge included in the standard unit price of items requisitioned. Although supply system customers pay the materiel managers for the services furnished by the Distribution Depots, materiel managers do not always provide those funds to the Distribution Depots in a timely manner. The following figure shows that during the B-month period ended 31 December 1996, the cumulative month-end value of services provided to materiel managers without a funded order or in excess of a funded order ranged from \$1 million to \$75.4 million:



**Cumulative Unfunded Services Provided
(October 1995 through December 1996)**

Service Continuation

Distribution Depots cannot stop providing services, even in the absence of funded orders from materiel managers, without incurring serious losses to DoD and without impairing the mission of combat forces. When items are received from a vendor or other source, the Distribution Depot cannot refuse to accept the delivery. Once accepted, the items must be stored; otherwise, the items could deteriorate and may not be available for issue to meet mission requirements. Items of different materiel managers are usually stored in the same warehouse. A Distribution Depot cannot close the warehouse without adversely affecting the items of materiel managers that have provided funds. In addition, the Distribution Depot should not refuse to issue and ship items requisitioned as the ultimate customer (the requisitioner) has already paid for those services.

Lack of Consequences

A primary reason that materiel management organizations did not provide timely funded orders to Distribution Depots was because they experienced no adverse consequences from not providing timely funded orders. The materiel management organizations knew that the services would be provided, regardless of funding.

Effect on Cash

DLA projected the Distribution Depots' cash collections to exceed cash disbursements for each month of FY 1996. However, FY 1996 cumulative month-end cash disbursements exceeded collections by \$127.7 million to \$18 1.4 million in the 3-month period ended January 31, 1996, and cumulative month-end collections exceeded disbursements during only 2 months of FY 1996. At the end of FY 1996, the Distribution Depot business area reported a negative \$7.4 million cash balance. This did not result in a violation of the Antideficiency Act as described in Title 31, United States Code, Section 1517(a), "Prohibited obligations and expenditures," because cash is managed at a level above the Distribution Depot business area. However, cash from other DBOF sources had to be used to cover the shortages resulting from the inability to bill full costs. For the first quarter of FY 1997, cumulative disbursements exceeded collections by \$263 million compared with DLA's

Finding B. Funding Depot Services

projection of \$56.2 million. The inability of the Distribution Depots to bill customers for unfunded services contributed to not attaining projected monthly cash outlay projections for the Distribution Depot business area. In addition, not obtaining projected cash balances in multiple business areas could cause an Antideficiency Act violation at the DBOF level.

Prior Audit

In April 1996, the General Accounting Office reported that Distribution Depots were performing work before receiving a funded order from customers. The General Accounting Office recommended that the Under Secretary of Defense (Comptroller) direct DoD organizations to follow existing DoD policy and to provide funding documents to DBOF organizations before starting work. In response to the recommendation, the Deputy Chief Financial Officer issued a memorandum on December 20, 1996, that required all DBOF Components to comply with DoD policy on performance of work and to abstain from performing work or services in the absence of or in advance of a funded customer order. As of March 31, 1997, the Distribution Depot business area was still providing these services to materiel managers in the absence of and in excess of funded customer orders.

Working Capital Fund Study Group

On February 14, 1997, DoD established the Defense Working Capital Fund (DWCF) Study Group to develop proposed recommendations for improving financial management of the DWCF. One of the six major issues addressed by the Subcommittee on Price Setting, Surcharges, and Requirements (the Subcommittee) was the lack of timely funded orders provided to DWCF organizations. The Subcommittee proposed to the DWCF Study Group on June 11, 1997, that the following steps be taken:

- o When a funded order has not been submitted after 15 days of providing the service, the DWCF organization should notify the comptroller of the customer organization and request a funded order.

o If funding is not received within 30 days of providing the service, the DWCF organization should notify the Under Secretary of Defense (Comptroller) and request authorization to directly bill the customer's appropriation account. The Under Secretary of Defense (Comptroller) should respond to the request within 15 days.

o When authorized by the Under Secretary of Defense (Comptroller), the DWCF organization may self-reimburse the DWCF, citing the customer's appropriation.

The DWCF Study Group approved the Subcommittee's recommendation and submitted it to the Under Secretary of Defense (Comptroller), who subsequently approved the recommendation and initiated action for implementation.

Summary

DoD needed to implement measures to ensure that funds are provided to Distribution Depots before services are rendered. The recommendation proposed by the DWCF Working Group and approved by the Under Secretary of Defense (Comptroller) should give customers an incentive to provide timely funded orders and enable Distribution Depots to collect amounts past due within a reasonable period of time. Accordingly, we are not making a recommendation at this time.

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Part II - Additional Information

Appendix A. Audit Process

Scope

We reviewed Distribution Depot revenues during our audit of the revenue accounts in the FY 1996 DBOF financial statements. As part of this review, we evaluated procedures used to recognize and report \$1.2 billion of revenue of the Distribution Depot business area in FY 1996. We also evaluated funding of workload related to secondary inventory items for the 15-month period ended December 31, 1996, and as of March 31, 1997. The Defense Finance and Accounting Service Columbus Center maintained the accounting records for the Distribution Depot business area.

Methodology

Work Performed. We evaluated procedures used to recognize and report Distribution Depot business area revenue from workload related to issue, receipt, storage, and over-ocean second-destination transportation of Military Department and DLA owned secondary inventory items; issue, receipt, and storage of Military Department owned major end items; and reimbursable projects. We also evaluated funding of workload related to Military Department and DLA owned secondary inventory items.

Audit Type, Dates, and Standards. We performed this financial-related audit from July through October 1997 in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD. Accordingly, we included tests of management controls considered necessary. We did not use computer-processed data for this audit.

Contacts During the Audit. We visited or contacted individuals and organizations within the DoD. Further details are available on request.

Management Control Program

DoD Directive 5010.38, "Management Control (MC) Program," August 26, 1996, requires DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

Scope of Review of Management Control Program. We reviewed the adequacy of DLA management controls related to revenue recognition for services provided by the Distribution Depot. Specifically, we reviewed reimbursement policies and procedures for workload related to issue, receipt, storage, and over-ocean second-destination transportation of Military Department and DLA owned secondary inventory items; to issue, receipt, and storage of Military Department owned major end items; and to reimbursable projects. We also reviewed the results of any self-evaluations of those management controls.

Adequacy of Management Controls. We identified material management control weaknesses as defined by DoD Directive 5010.38. Management controls at DLA were not adequate to ensure that services were not provided at less than the full cost or for no charge and that no work or services were performed in advance of or in excess of the amount of a funded order. Ongoing and planned management actions will improve Distribution Depot revenue recognition procedures for services rendered. Recommendation A, if implemented, will result in full disclosure of future funding deficiencies in the financial statements. We will provide a copy of the report to the senior official responsible for DLA management controls.

Adequacy of Management% Self-Evaluation. DLA officials did not identify Distribution Depot revenue recognition as an assessable unit and, therefore, did not identify or report the management control weakness identified by the audit.

Appendix B. Summary of Prior Coverage

General Accounting Office

Report No. AIMD-96-54 (OSD Case No. 1109), "Defense Business Operations Fund: DoD Is Experiencing Difficulty in Managing the Fund's Cash," April 10, 1996. The review was requested by the Ranking Minority Member of the House Committee on National Security. The report discusses various causes of problems in cash management within the DBOF. The audit found that the Distribution Depot business area performed work before receiving a funded order from customers, resulting in the depots not being able to bill customers for work performed in October 1995 and November 1995 until December 1995. The report recommended that the Under Secretary of Defense (Comptroller) direct DoD activities to follow existing DoD policy and to provide funding documents to DBOF organizations before starting work. In response to the recommendation, the Deputy Chief Financial Officer issued a memorandum on December 20, 1996, that required all DBOF organizations to abstain from performing work or services in the absence of or in advance of a funded customer order. As noted in our report, this practice continues.

Inspector General, DoD

The Inspector General, Department of Defense, previously issued six reports on issues identified during the audit of the revenue accounts in the FY 1996 DBOF financial statements:

Report No. 98-050, "Audit Report on Defense Business Operations Fund Adjustments at the Defense Finance and Accounting Service Denver Center," January 20, 1998. The report states that the Defense Finance and Accounting Service Denver Center did not have adequate supporting documentation for 111 adjustments totaling \$217.5 billion made to the Air Force, U.S. Transportation Command, and Joint Logistics Systems Center FY 1996 Defense Business Operations Fund account balances. The last nine adjustments without supporting documentation brought the Air Force Defense Business Operations Fund Results of Operation from a loss of \$11 billion to a gain of \$2.2 billion, and the lack of audit trails contributed to the disclaimed

audit opinion for the FY 1996 Defense Business Operations Fund financial statements. In many instances, adjustments were made to the same accounts because the adjustments were recorded incorrectly, reversed, reestablished, decreased, or increased. However, we could not determine the validity of the adjustments because of the lack of supporting documentation. As a result, the FY 1996 Defense Business Operations Fund financial statements of the Air Force, U.S. Transportation Command, and Joint Logistics Systems Center were subject to higher risk for material misstatement. We recommended that the Director, Defense Finance and Accounting Service, issue written guidance for making adjustments. We also recommended that the Director, Defense Finance and Accounting Service Denver Center, establish procedures to ensure that adequate explanation and supporting documentation are provided for adjustments. The Defense Finance and Accounting Service Deputy Director for Accounting nonconcurred with the recommendation to issue written guidance for making adjustments and partially concurred with the recommendation to establish procedures at the Defense Finance and Accounting Service Denver Center for making adjustments. We have requested that the Director, Defense Finance and Accounting Service, reconsider the position stated in the Deputy Director for Accounting's comments.

Report No. 97-091, "Revenue Recognition Policies for the Army Defense Business Operations Fund," February 12, 1997. The report states that the Army planned to update the Standard Industrial Fund System to meet DoD 7000.14-R revenue recognition requirements that were superseded by Office of Management and Budget Statement of Federal Financial Accounting Standards No. 7 on October 1, 1997. As a result, DoD would have needlessly spent approximately \$45,000 to reconfigure the Standard Industrial Fund System and would have failed to address a potential impediment to a favorable financial statement audit opinion. We recommended that the Under Secretary of Defense (Comptroller) advise the Army Industrial Operations Command to suspend making the system change until it has been determined how DoD will implement the Office of Management and Budget revenue recognition standard for contracts. The Deputy Chief Financial Officer nonconcurred with the recommendation for the Army to suspend making the system change. However, the Army Industrial Operations Command suspended action to change the system. As a result, the intent of the recommendation was satisfied.

Report No. 97-081, "Appropriated Capital Used in the FY 1995 Defense Business Operations Fund Financial Statements," January 27, 1997. The report states that the FY 1995 DBOF consolidated financial statements did not correctly report the appropriated funds used by DBOF for commissary operations. As a result, the FY 1995 DBOF financial statements understated revenues and financing sources by \$940 million and overstated the shortage of revenues and financing sources over expenses by a like amount. We recommended that the Under Secretary of Defense (Comptroller) rescind an erroneous policy instruction and ensure that future instructions adhere to established DoD policy. We also recommended that the Director, Defense

Appendix B. Summary of Prior Coverage

Finance and Accounting Service, correct the FY 1995 error in the FY 1996 comparative financial statements. Although the Deputy Chief Financial Officer agreed to the recommendations, the FY 1996 comparative financial statements were not corrected. However, the FY 1997 statements reporter, appropriated capital used.

Report No. 97-040, "Distribution Depot Over-Ocean Second-Destination Transportation Costs," December 10, 1996. The report states that transportation costs applicable to other DoD organizations were erroneously charged to the Distribution Depot business area of the DBOF. Our review of three summary bills of 104,878 shipments, totaling \$26.8 million, showed that \$10.5 million (39 percent) was erroneously charged to the Distribution Depot business area. After our review, a management consulting firm hired by the DLA found an additional \$4 1.8 million (27 percent) of \$155.7 million paid from April 1995 through March 1996 was not applicable to the Distribution Depot business area. As a result, the Distribution Depot business area paid for material amounts of transportation costs that should have been paid by other DoD organizations. In FY 1995, the Distribution Depot business area lost \$102 million in over-ocean second-destination transportation costs; this loss was caused partly by erroneous bills. We recommended that the Director, DLA, change the payment policy to required the Defense Distribution Regions to pay only those charges applicable to the Distribution Depot business area.

Management actions planned were responsive to the recommendations.

Report No. 96-198, "Defense Logistics Agency Revenue Eliminations," July 22, 1996. The report states that when the DLA made sales to other DBOF organizations, the resulting revenues were not eliminated from the amount reported in the FY 1995 financial statements, as required by Under Secretary of Defense (Comptroller) guidance. Consequently, the \$13.3 billion of revenue reported by DLA in the FY 1995 DBOF consolidated financial statements was overstated by \$8.4 billion (63 percent) and by \$0.6 billion in the DLA financial statements. We recommended that the Defense Finance and Accounting Service establish procedures to eliminate revenues from sales to intrafund customers when preparing financial statements. We also recommended that DLA review, identify, and request correction of any deficiencies in the proposed financial statements. Management actions planned were responsive to the recommendations.

Report No. 96-160, "Defense Business Operations Fund Equity Transfer-Defense Commissary Agency," June 13, 1996. The report states that at the direction of an official in the Office of the Under Secretary of Defense (Comptroller), the Defense Commissary Agency erroneously reported a \$25 1.6 million transfer of equity from the DLA segment of the DBOF as revenue in the FY 1995 financial statements. As a result, revenues and net results of operations were overstated by \$25 1.6 million in the FY 1995 DBOF consolidated financial statements. We recommended that the FY 1995 financial statements be corrected and that only appropriate officials be allowed to issue

Appendix B. Summary of Prior Coverage

consolidated financial statements. We recommended that the FY 1995 financial statements be corrected and that only appropriate officials be allowed to issue accounting policy. The Deputy Chief Financial Officer agreed to correct the FY 1995 financial statements.

Appendix C. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Acquisition and Technology)
Deputy Under Secretary of Defense (Logistics)
Director, Defense Logistics Studies Information Exchange
Under Secretary of Defense (Comptroller)
Deputy Chief Financial Officer
Deputy Comptroller (Program/Budget)
Director for Accounting Policy
Assistant Secretary of Defense (Public Affairs)

Department of the Army

Commander, Army Materiel Command
Auditor General, Department of the Army

Department of the Navy

Assistant Secretary of the Navy (Financial Management and Comptroller)
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Director, Defense Finance and Accounting Service
 Director, Defense Finance and Accounting Service Columbus Center
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Director, Defense Logistics Agency
 Commander, Defense Distribution Region East
 Commander, Defense Distribution Region West
Director, National Security Agency
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Office of Management and Budget
Technical Information Center, National Security and International Affairs Division,
 General Accounting Office

Chairman and ranking minority member of each of the following congressional
committees and subcommittees:

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
House Committee on Appropriations
House Subcommittee on National Security, Committee on Appropriations
House Committee on Government Reform and Oversight
House Subcommittee on Government Management, Information, and Technology,
 Committee on Government Reform and Oversight
House Subcommittee on National Security, International Affairs, and Criminal
 Justice, Committee on Government Reform and Oversight
House Committee on National Security

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Part III - Management Comments

Defense Logistics Agency Comments



DEFENSE LOGISTICS AGENCY
HEADQUARTERS
8725 JOHN J. KINGMAN ROAD, SUITE 2533
F T. BELVOIR, VIRGINIA 221

12 JAN 1998

IN REPLY
REFERRED TO DDAI

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING DEPARTMENT OF DEFENSE

SUBJECT: Draft Report: Distribution Depot Revenues (Project No. SPD-2020.07)

This is in response to the November 10, 1997 request. If you have any questions, please contact Mr. Dave Stumpf, (703) 767-6266.

Encl

A handwritten signature in black ink, appearing to read "JEFFREY GOLDSTEIN".

JEFFREY GOLDSTEIN
Chief (Acting), Internal Review

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Defense Logistics Agency Comments

32 JAN 1998

Subject: Distribution Depot Revenues (Project No. 5FD-2020.07)

Finding A. Reimbursement for Services. The Defense Logistics Agency (DLA) Distribution Depot business area was not reimbursed for all transportation and container consolidation point (CCP) services in FY 1996. This lack of full reimbursement was not disclosed in the FY 1996 financial statements. Customers were billed only \$126 million of \$275.5 million of costs incurred because DoD policy prevented DBOF entities from billing customers in excess of funded amounts. DLA Distribution Depot business area customer budgeted for and funded only \$126 million for transportation services but did not budget for or fund CCP services. In addition, DLA officials had not developed a methodology to allocate the cost of services provided to specific customers and had not developed stabilized rates or unit prices for CCP services. DLA officials overlooked the need to disclose in the financial statements the lack of full reimbursement to DBOF. As a result, the Distribution Depot business area lost approximately \$150 million in FY 1996, and the financial statements did not include information important to users of those financial statements.

DLA Comments: We concur. DLA will disclose these losses in the FY1997 and FY1998 CFO statements.

Internal Management Control Weakness: Nonconcur.

Action Officer: Lanier McCaskill, FOXS
Review/Approval: Jim O'Laughlin/Billie Blackman, FOX
Coordination: Dave Stumpf, DDAI, 767-6266

DLA Approval:



E.R. CHAMBERLIN
Rear Admiral, SC, USN
Deputy Director

Defense Logistics Agency Comments

JJ JJJ JJJ

Subject: Distribution Depot Revenues (Project No. SFD-2020.07)

Recommendation A. 1.: We recommend that the Director, Defense Logistics Agency, disclose the nature and amounts of future losses resulting from not charging customers for full costs of transportation and container consolidation point services in the Distribution Depot business area financial statements.

DLA Comments: We concur with the recommendation that full disclosure of the nature and amounts of losses be included in the CFO statements. We have taken steps to make a full disclosure in the 1997 financial statements.

Disposition: Action is considered complete.

Monetary Benefits:

Action Officer: Lemier B. McCaskill, FOXS, 767-7235

Review/Approval: Jim O'Laughlin/Billie Blackman, FOX

Coordination: Dave Stumpf, DDAI, 767-6266

DLA Approval:



E.R. CHAMBERLIN
Rear Admiral, SC, USN
Deputy Director

Audit Team Members

The Finance and Accounting Directorate, Office of the Assistant Inspector General for Auditing, DoD, produced this report.

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